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R76-82

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76-193

The Honorable Ernest Garfield
Chairman
Arizona Corporation Commission
2222 West Encanto Boulevard
Phoenix, Arizona 85009

Re: Commission Power to Provide for Rate Increases in Certain Instances Without a Finding of Fair Value.

Dear Chairman Garfield:

On February 11, 1976, you sent us a copy of an amendment to Senate Bill 1069 proposed to the Senate Natural Resources Committee. In an accompanying letter you requested an opinion on the following question, as posed by you:

> Is the Corporation Commission able to pass a General Order to implement the provisions called for in the amendment with the exception of paragraph E?

The proposed amendment to which you refer would completely supersede the printed bill and would purportedly expand the Commission's power to make rate adjustments for public utilities in significant respects.

Prefatorily, as you know, the Commission regards itself bound to consider the granting of general rate increases for fixed utilities only in connection with what is usually termed a "full rate case". A full rate case is a proceeding involving establishment of a fair value for the utility's properties; determination of allowable expenses; ascertainment of revenues realized under current, existing rate schedules; and determination of a fair rate of return on the fair value of the company. All these calculations are based upon actual figures (with certain permissible adjustments) derived from a historical test year ending as close as possible to the time of the inquiry.

This rate-fixing procedure is calculated to produce rates which would have resulted in a fair rate of return during the test period. However, since the rates are actually applied to future operations, the methodology has been criticized as obsolete in this era of high inflation and rapidly-growing capital needs for plant expansion. Rate increases approved by the Commission, these critics argue, are in many cases already confiscatory when they are put into effect. A new rate case would be of some help, but it would never enable the utility to earn the authorized rate of return under economic conditions existing today, because the data used is always out of date. Furthermore, the argument goes, it is both unconscionably costly for all concerned and physically impossible for the Commission to conduct enough rate cases for all the utilities under its jurisdiction to keep up with the need for rate relief.

Because the Commission has taken the view on legally sound ground that it must adhere to this traditional rate-making format, the utilities and others have been seeking ways around this legal impasse. One such approach, with which you are intimately familiar, was taken in the lawsuit brought by Arizona Public Service Company to test its most recent rate order. Judge Case's findings and judgment, as you know, set aside the Commission's order on the grounds that the rates so established were confiscatory from the time of their implementation and for a reasonable time thereafter because of additions to plant already made and soon to be made subsequent to the end of the test period. Judge Case determined that the commission, in order to establish nonconfiscatory rates, must consider

> . . . both the added plant and other significant investments which can be expected to be in service to the public during the period the allowed rates can reasonably be expected to be in effect, and the added costs which are not offset by expected savings or additional revenues.

The Court's judgment leaves broad latitude in the Commission to determine what items should be so considered and the methodology by which the judgment should be effectuated. The Commission has now directed that an appeal be taken from Judge Case's decision.

Assuming Judge Case's decision is sustained in appeal, one of the methods by which the Court's mandate might be carried out is by holding hearings within a twelve-to

eighteen-month period subsequent to the full rate case decision to determine whether plant additions, projected at the time of the full rate case to be placed in service within a reasonabble time after new rates have been effective, actually have come into service as expected. Then, if the projected plant additions are found to be in service, the rate of return allowed in the full rate case would be applied to the value of the plant additions, and rate schedules would be authorized which are designed to bring in the additional required revenue.

The proposed amendment to Senate Bill 1069 would accomplish virtually the same purpose. Although the factors that might be considered in the abbreviated rate hearings contemplated in the bill as amended are perhaps broader in scope than those contemplated in the A.P.S. suit, the concept is the same, and if the A.P.S. decision is upheld, in all likelihood the method outlined in the bill amendment would likewise be held constitutional.

Because the Judge Cases' decision is going to be appealed, and because the Attorney General does not render opinions on issues pending litigation, we are unable to say at this time whether the Constitution of Arizona permits the procedure outlined in the proposed amendment to Senate Bill 1069--whether mandated by the Legislature or by the Commission itself.

One other point should be noted. If the procedure outlined in the proposed amendment is utlimately held to be constitutional, the Commission would have full and complete jurisdiction to implement the procedure even if Senate Bill 1069 as amended (or any equivalent legislation, for that matter) is not enacted by the Legislature. See Ethington v. Wright, 66 Ariz. 382, 189 P.2d 209 (1948).

To recapitulate, until the A.P.S. appeal is concluded, we cannot render an opinion as to whether the contemplated procedure is constitutional. It is clear, however, that if the procedure is ultimately held constitutional the Commission independently may decide whether and how to implement it.

Sincerely,

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cc: Mr. Donald E. Vance